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No. 89-746

In The

Supreme Court of the United States

October Term, 1989

GENE R. SMITH CORPORATION,

Petitioner,

v.

TERRY'S TRACTOR, INC., a California corporation; GEORGE LARABEE, individually and doing business as L & L CONSTRUCTION AND L & L ELECTRIC; and WALTER L. SCHWAAR, individually and doing business as THE LIGHT GALLERY,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

The California state trial court, following a recent Ninth Circuit opinion, held that a claim for damages arising out of an allegedly wrongful filing of an involuntary bankruptcy petition is within the exclusive jurisdiction of the Bankruptcy Court and therefore petitioner's state court action for malicious prosecution and abuse of process was barred. 11 U.S.C. § 303(i) provides remedies, within the bankruptcy setting, which exceed those available in common law for malicious prosecution and abuse of process. The state trial court decision was affirmed on appeal.

Should the U.S. Supreme Court review a California state court decision that the Bankruptcy Court has exclusive jurisdiction for damage claims arising out of the allegedly wrongful institution of an involuntary bankruptcy petition?

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INTRODUCTION

In *Gonzales v. Parks*, 830 F.2d 1033 (9th Cir. 1987), the Ninth Circuit noted that the Bankruptcy Court has exclusive jurisdiction regarding damage claims brought by one maintaining that a bankruptcy petition was wrongfully instituted. For debtors against whom involuntary bankruptcy petitions have been wrongfully commenced, the generous remedies are set forth in 11 U.S.C. § 303(i), and consist of costs, attorneys' fees, compensatory damages, and punitive damages.

There is a clear incompatibility between state court jurisdiction and federal interests in regard to determining the propriety of a bankruptcy petition and potential redress for wrongfully instituted bankruptcy petitions.

Matters arising under bankruptcy law have long been the exclusive province of federal bankruptcy courts. State court jury verdicts would have a chilling effect on one's exercising the federal right to petition for bankruptcy. Moreover, by allowing a separate state cause of action for wrongfully instituting bankruptcy petitions, there would arise differing standards by which to evaluate identical conduct.

In this case, the petitioner, GENE R. SMITH CORPORATION (hereinafter "Petitioner"), was subject to an involuntary Petition for Bankruptcy brought by respondent TERRY'S TRACTOR, INC., and joined by respondent WALTER L. SCHWAAR, individually and dba THE LIGHT GALLERY (hereinafter "Respondents"), which was dismissed without prejudice. Petitioner, with apparent full knowledge of the generous remedies set forth in 11 U.S.C. § 303(i), chose to ignore that section and proceed with a malicious prosecution and abuse of process lawsuit in state court.[1]

The availability of 11 U.S.C. § 303(i), which sets forth remedies greater than those available in state court, coupled with the clear incompatibility between state court

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[1] One can only speculate why Petitioner did not want the bankruptcy judge who dismissed the Petition, the individual in the best position to evaluate the bad faith or lack thereof on the part of Respondents, to rule upon the propriety of the Petition.

jurisdiction and federal interests in regard to determining the propriety of bankruptcy petitions and potential redress for wrongfully instituted bankruptcy petitions, compels this Court to deny the Petition.

REASONS FOR DENYING THE WRIT

None of the reasons proffered by Petitioner are persuasive upon even the most cursory examination.

A. The Argument That the *Gonzales* Case Is Inapplicable.

In *Gonzales v. Parks*, 830 F.2d 1033 (9th Cir. 1987), the Ninth Circuit held that since federal courts have exclusive jurisdiction over bankruptcy matters, Congress and the federal courts, not state courts, determine what incentives and penalties are appropriate for bankruptcy violations. In *Gonzales, supra*, Jerome and Barbara Parks sued Richard and Juliana Gonzales (and their attorney, Michael Dodge) for abuse of process arising out of the Gonzales' filing of a Chapter 11 bankruptcy petition, a filing which was apparently done in an effort to avoid the Parks' efforts to foreclose upon a deed of trust held on real property owned by the Gonzales. The District Court granted defendant Gonzales' motion for summary judgment, after which the matter was appealed to the Ninth Circuit.

Without dissent, the Ninth Circuit affirmed the District Court's granting of defendant Gonzales' motion for summary judgment on the ground that state tort law

cannot afford a cause of action for the filing of a frivolous bankruptcy claim, and noted that state courts have no jurisdiction to adjudicate a claim that a bankruptcy filing was frivolous:

> *Implicit in the Parkses' appeal is the notion that state courts have subject matter jurisdiction to hear a claim that the filing of a bankruptcy petition constitutes an abuse of process. We disagree with that assumption.* Filings of bankruptcy petitions are a matter of exclusive federal jurisdiction. State courts are not authorized to determine whether a person's claim for relief under a federal law, in a federal court, and within that court's exclusive jurisdiction, is an appropriate one. Such an exercise of authority would be inconsistent with and subvert the exclusive jurisdiction of the federal courts by allowing state courts to create their own standards as to when persons may properly seek relief in cases Congress has specifically precluded those courts from adjudicating. Cf. *Siravo v. Siravo*, 424 A.2d 1047, 1049-50 (R.I. 1981) (because the bankruptcy courts have exclusive jurisdiction over bankruptcy, a bankruptcy court's determination that a section of the Bankruptcy Act is unconstitutional may not be challenged in a state court). The ability collaterally to attack bankruptcy petitions in the state courts would also threaten the uniformity of federal bankruptcy law, a uniformity required by the Constitution. U.S. Const. art. I, § 8, cl. 4.
>
> That Congress' grant to the federal courts of exclusive jurisdiction over bankruptcy petitions precludes collateral attacks on such petitions in state courts is supported by the fact that remedies have been made available in the federal courts to creditors who believe that a filing is frivolous. Debtors filing bankruptcy petitions are subject to a requirement of good faith, *In re Thirtieth Place, Inc.*, 30 B.R. 503, 505 (Bankr.App.

> 9th Cir. 1983), and violations of that requirement can result in the imposition of sanctions. *In re 2218 Bluebird Ltd. Partnership*, 41 B.R. 540, 542-43 (Bankr. S.D. Calif. 1984); see *In re Villareal*, 46 B.R. 284 (Bankr. C.D. Calif. 1984) (sanctions awarded because debtor's filing was "an abuse of the bankruptcy process"); Bankr. R.9011. Cf. 11 U.S.C.A. § 303(i)(2) (Supp. 1987) (*authorizing the imposition of sanctions on petitions for involuntary bankruptcy petitions filed in bad faith). Congress' authorization of certain sanctions for the filing of frivolous bankruptcy petitions should be read as an implicit rejection of other penalties, including the kind of substantial damage awards that might be available in state court tort suits.* Even the mere possibility of being sued in tort in state court could in some instances deter persons from exercising their rights in bankruptcy. In any event, it is for Congress and the federal courts, not the state courts, to decide what incentives and penalties are appropriate for use in connection with the bankruptcy process and when those incentives or penalties shall be utilized. [Emphasis added.]

Id. at 1035-1036.

Petitioner argues that since the underlying bankruptcy matter has concluded, it is not barred from pursuing a state court action for abuse of process and malicious prosecution. Petitioner suggests under *Gonzales v. Parks, supra,* that such an action would be barred *only* during the pendency of the bankruptcy action. There is no authority for this position. *Gonzales, supra,* is contrary authority for this position. A reading of that case reveals that it does *not* hold that the lack of subject matter jurisdiction and federal preemption can only be raised during the pendency of the bankruptcy matter.

In *Gonzales, supra,* the trial judge had granted defendant's motion for summary judgment based upon his belief that the state court action was void at its inception as violative of the automatic stay provision of the Bankruptcy Act. Thus, the *trial court* did in some fashion believe that the pendency of the bankruptcy action precluded the state court action. *The Ninth Circuit, however, affirmed the court's decision on other grounds.* ("We affirm the bankruptcy court's decision on other related grounds." *Gonzales, supra,* at p. 1035.) The Ninth Circuit expressly noted that it was *not* basing its decision upon the pendency of the bankruptcy action as it was not clear that the automatic stay provision of 11 U.S.C. § 362(a) was applicable, inasmuch as Section 362(a) provides an automatic stay to prior debts and obligations, and the alleged abuse of process (the filing of the bankruptcy action, itself) was not a prior debt or obligation, but rather occurred at the moment of filing by virtue of the filing. *Ibid.*

The Ninth Circuit opinion goes on to state that federal courts have exclusive jurisdiction over claims regarding the alleged wrongfulness of a bankruptcy petition. Nowhere is there mention of this "pendency requirement" which petitioner wishes the court to read into that decision.

In unambiguous language, the *Gonzales* court states:

> For the same reasons that we conclude *infra* that state courts have no jurisdiction to adjudicate any claim that a bankruptcy filing was frivolous, state tort law cannot afford a cause of action for the filing of a frivolous claim.

830 F.2d at 1035.

The court further stated:

> Implicit in the Parkses' appeal is the notion that state courts have subject matter jurisdiction to hear a claim that the filing of a bankruptcy petition constitutes an abuse of process. We disagree with that assumption.

830 F.2d at 1035.

When one examines one of the main rationales behind the federal preemption position, it is clear that tacking on a "pendency requirement" does not subserve the rationale. In *Gonzales, supra,* the court noted:

> Even the mere possibility of being sued in tort in state court could in some instances deter persons from exercising their rights in bankruptcy.

830 F.2d at 1036.

If one could wait until the bankruptcy action is completed, and then sue for malicious prosecution or abuse of process, clearly such could "deter persons from exercising their rights in bankruptcy," a very reason behind not allowing state court remedies in cases of this nature.

B. The Argument That There Is No Legislative History Which Indicates the Bankruptcy Court Has Exclusive Jurisdiction Over Claims for Wrongfully Instituted Bankruptcy Petitions.

Petitioner argues that there is no discernible intent from the legislative history that there be exclusive jurisdiction regarding improperly instituted bankruptcy petitions and, accordingly, there must be concurrent jurisdiction.

The presumption of concurrent jurisdiction need not be rebutted by a legislative history, alone. The presumption of concurrent jurisdiction can be rebutted by "a clear incompatibility between state-court jurisdiction and federal interests." *Gulf Offshore Company v. Mobil Oil Corporation*, 453 U.S. 473, 478 (1981) ("Congress, however, may define jurisdiction to the federal courts either explicitly or implicitly. Thus, the presumption of concurrent jurisdiction can be rebutted by an explicit statutory directive, by unmistakable implication from legislative history, *or by a clear incompatibility between state-court jurisdiction and federal interests.*" [Emphasis added.])

Allowing state court jurisdiction over claims for wrongfully instituted bankruptcy petitions would clearly represent an incompatibility between state court jurisdiction and federal interests:

1. If an individual against whom a petition for bankruptcy was improperly brought could thereafter avail himself of a state court lawsuit, such would create a chilling effect upon the exercise of a very important federal right, i.e., the right to petition for involuntary bankruptcy. Individuals might be deterred from exercising their federal bankruptcy rights because of a fear that such an exercise might result in being sued in state court.

2. If state courts were permitted to entertain claims of malicious prosecution in cases of wrongfully instituted bankruptcy petitions, there would arise a body of state law in each state regarding the propriety of filing bankruptcy petitions which may differ from state to state as well as from federal law. California, for example, could come up with a more liberal body of law as to what

constitutes malicious prosecution in filing a petition for involuntary bankruptcy than that developed in Georgia or other states. The federal standard of "bad faith" set forth in 11 U.S.C. § 303(i)(2) might differ from the states' standards of malice. Different standards evaluating identical conduct would hamper the uniform law to be applied in bankruptcy proceedings. By leaving jurisdiction exclusively with the federal courts, with 11 U.S.C. § 303(i)(2) as the sole remedial measure, however, uniform standards would develop which would govern all citizens of the United States in regard to the exercise of the federal right to petition for involuntary bankruptcy.

3. The remedies set forth in 11 U.S.C. § 303(i) consist of costs, attorneys' fees, compensatory damages, and punitive damages, remedies which are equal to, or in the case of attorneys' fees greater than, those available for a state cause of action for malicious prosecution in California. In California, the attorneys' fees incurred in the prosecution of a malicious prosecution action are not recoverable. California Code of Civil Procedure 1021. Thus, any element of damage theoretically recoverable in state law is subsumed by the available remedy in federal law. By enacting such a broad remedial measure as 11 U.S.C. § 303(i), a measure which provides remedies in excess of those available for common law claims for malicious prosecution, Congress was not merely intending to supplement state remedies, but rather intended to subsume and preempt them.

4. Under 11 U.S.C. § 303(i), the bankruptcy judge who had ruled on the propriety of the involuntary bankruptcy petition is the same judge who determines what

award of damages, if any, is given as a result of a wrongfully filed petition for involuntary bankruptcy. This is an excellent arrangement, inasmuch as that particular judge is in a better position to evaluate the existence, or lack thereof, of good faith in the filing of the bankruptcy petition than a jury in a state court looking at the matter years later. In California, absent certain exceptions not applicable in this scenario, a judge may not be called as a witness to testify in a subsequent proceeding about a matter over which he had previously presided. California Evidence Code section 703.5. Thus, in a malicious prosecution lawsuit brought in state court, the individual in the best position to evaluate the propriety of the bankruptcy petition, i.e., the bankruptcy judge who dismissed the improperly filed petition, is precluded from testifying.

5. Another advantage of the federal remedy over a potential state court remedy would be the fact that redress, if any, could be accomplished within a very short period of time. The bankruptcy judge could take evidence and rule on the propriety of the filing shortly after dismissal of the involuntary bankruptcy petition whereas if the matter were to proceed by way of a complaint in state court, the case could languish for several years before trial.

6. Absent a successful defense of collateral estoppel, a debtor could *unsuccessfully* move for sanctions pursuant to 11 U.S.C. § 303(i) for a claimed malicious filing, only to turn around and *successfully* sue for malicious prosecution in state court, thereby resulting in an award inconsistent with a prior bankruptcy determination. Of course,

the reverse could also take place, with the debtor receiving a finding of a bad faith filing on the part of a creditor in a bankruptcy proceeding, and then attempt to sue for malicious prosecution in state court, only to lose the state court action. In either event, there would be inconsistent results in different forums based upon the same set of operative facts.

Petitioner cites *Kensington Development Corp. v. Israel*, 142 Wis.2d 894, 419 N.W.2d 241 (1988), as the only case to consider *Gonzales v. Parks*, 830 F.2d 1033 (9th Cir. 1987), claiming that in *Kensington, supra*, the Wisconsin Supreme Court held that state tort claims could be asserted once the bankruptcy court dismisses the bankruptcy action case. Petitioner is incorrect in stating that the *Kensington, supra*, case is the only case to consider *Gonzales, supra*, and has further mischaracterized the holding in *Kensington, supra*. *Kensington, supra*, did not involve allegations of a wrongfully filed bankruptcy petition. Rather, in *Kensington, supra*, an unsecured creditors' committee and its attorney filed an allegedly sham and frivolous lis pendens in connection with an adversary complaint in a Chapter 11 bankruptcy. The adversary complaint was dismissed for lack of jurisdiction, and the dismissal order included a provision which ordered the defendants to withdraw the lis pendens notice. Plaintiffs alleged the lis pendens clouded title to their property for over four months and interfered with sales of the property. The Wisconsin Supreme Court held that plaintiff could file a state court action arising out of the filing of a sham or frivolous lis pendens. ("State courts regularly determine issues involving alleged false, sham or frivolous instruments, the subject matter of [Wisconsin's slander of title

section]." 419 N.W.2d at 243.) Significantly, in *Kensington, supra*, the filing of the bankruptcy petition, an act authorized by federal law, was *not* an issue. Rather, the issue was whether the filing of a lis pendens, an act authorized by state law, was actionable in state court.

Another Wisconsin case, not cited by Petitioner, noted with approval the holding in *Gonzales v. Parks, supra*. In *Gonzales v. AM Community Credit Union*, 150 Wis.2d 773 (1989), the Wisconsin appellate court held that a discharge in bankruptcy acts as an injunction against actions to collect on a debt, but does not bar state causes of action to vindicate collection abuses nor reserve exclusive protection of those acts to the federal court. In so holding, the court distinguished its facts from *Gonzales v. Parks, supra*, which involved the wrongful initiation of a bankruptcy petition, the remedies for which, according to this Wisconsin appellate court, lie exclusively in federal court. The Wisconsin court noted that filing a lawsuit as a result of a claimed wrongful bankruptcy petition is an act which essentially arises under title 11 and, accordingly, such action must be brought in district court, which has original and exclusive jurisdiction of all cases under title 11 pursuant to 28 U.S.C. § 1334(a) ("Except as provided in subsection (b) of this section, the district court shall have original and exclusive jurisdiction of all cases under title 11."):

> Therefore, this case is very different from *Gonzales v. Parks*, 830 F.2d 1033 (9th Cir. 1987) on which AMC relies. *Parks* is a case 'under' title 11. In that case, the court stated that 'it is for Congress and the federal courts, not the state courts, to decide what incentives and penalties are appropriate for use in connection with the

> bankruptcy process and when those incentives or penalties shall be utilized.' *Id.* at 1036. This statement must be read in its context: a discussion of whether a state court may hear a claim that the filing of bankruptcy petition constitutes abuse of process. *Id.* at 1035.
>
> The *Parks* court noted that bankruptcy filings are a matter of exclusive federal jurisdiction. *Id.* Filings are claims for relief under federal law and they constitute cases under title 11, over which the federal courts have exclusive jurisdiction. *Id.* at 1035 & n. 6. A grant of exclusive jurisdiction includes the implied power to protect that grant. *Id.* at 1036.
>
> While the underlying federal question in *Parks* was the validity of the bankruptcy filing, the underlying question in this case is the validity of the wage deduction. Since filings are exclusively within the province of the federal courts, attacks on filings must be mounted in the federal courts.

150 Wis.2d at 781.

C. The Argument That Exclusive Jurisdiction Within the Federal Bankruptcy Court for Claims of Wrongfully Instituted Bankruptcy Petitions Would Be Unconstitutional.

Petitioner maintains that to interpret 11 U.S.C. § 303(i) as preemptive of state malicious prosecution and abuse of process actions would render that section unconstitutional, inasmuch as an aggrieved party would be deprived of a right to a jury trial regarding the propriety of the bankruptcy petition.

Petitioner did not raise this issue at the trial level. At the state appellate level, Petitioner devoted a mere three

sentences to this argument in his opening brief, and ignored it in his reply brief. In its petition to the Supreme Court of the State of California, Petitioner ignored this argument, devoting not a single sentence to it.

The reason for Petitioner's neglect of this argument is obvious and merits little or no response. There is no constitutional right to a jury trial in matters that arise out of the bankruptcy process even if a jury would be available had the claim been made outside of the bankruptcy setting. *Katchen v. Landy*, 382 U.S. 323, 336-337 (1965); *Barton v. Barbour*, 104 U.S. 126, 133-134 (1881).

CONCLUSION

An aggrieved debtor against whom an involuntary bankruptcy petition has been instituted in bad faith has available to him broad, generous remedies pursuant to 11 U.S.C. § 303(i). Whether a bankruptcy petition has been commenced in bad faith and what remedies, if any, are available to the individual against whom the bankruptcy petition has been wrongfully filed are issues that arise under bankruptcy law and are matters for which there is exclusive jurisdiction in the federal bankruptcy court. Accordingly, Petitioner's state court claims for malicious prosecution and abuse of process were properly dismissed by the state trial court, a dismissal which was affirmed through the California state appellate system. There is a clear incompatibility between state court jurisdiction and federal interests in this area.

The petition should be denied.

Respectfully submitted,

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